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The Significance of the Edge Law in Relation to Foreign Trade

By PHILIP B. KENNEDY

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THE Edge Law¹ approved December 24, 1919, provides for the federal incorporation under special provisions of international banks for financing our foreign trade. This law came into effect at a time when there was urgent need of extending credits to foreign countries in order to maintain a market for American exports. During the year 1919 our exports exceeded our imports by four billion dollars. This large favorable balance was offset primarily by our government loans extended during the year. It was announced early in 1920 that further government loans would not be made. The burden of extending foreign credits, therefore, would have to be borne by private investment. The Edge Law was calculated to furnish banking machinery which would enable widespread and, at the same time, safe participation in this financing by banks and individuals in different parts of the country. National banks are permitted to subscribe to stock in Edge Law banks up to 10 per cent of their capital and surplus.²

A large measure of discretion was wisely given to the Federal Reserve Board in the making of regulations. After careful study of this law and its possibilities, the Board issued its first regulations, March 23, 1920. In an analysis of the law and regulations, which is essential to a clear understanding of the powers and limitations, it will be noticed that many matters are subject to the approval of the

Federal Reserve Board.¹ The Board in its regulations has partially opened the door and has the power to open it wider as special problems develop. The character of financing to be done by Edge Law banks will therefore be a matter of growth, based on specific experience and conservative regulation.

The careful and conservative manner in which the Federal Reserve Board has approached its task of supervising Edge Law banks is due to its desire to proceed in accordance with sound banking practice and public policy and not through any lack of interest or support. The Board was of great assistance in giving advice in connection with the drafting of the Act, and has since followed the organization of Edge Law banks with close attention. Governor W. P. G. Harding, in a very able speech at the Annual Banquet of New York City bankers, January 17, stated that conditions in this country would not be normal until conditions in Europe were well on the way back to normal, and that American producers had therefore a vital interest in the extension of credits to Europe. In this connection he referred hopefully to the service which might be rendered by banks organized under the Edge Law.

The need for the extension of a reasonable amount of foreign credits is even more apparent at this time than it was a year ago.

DEPRECIATION OF EXCHANGE

Immediately following the armistice, import restrictions in various coun-

¹ An analysis of the law and regulations is given at the end of this article, p. 137.

¹ Section 25 (a) of the Federal Reserve Act.

² See late ruling in *Federal Trade Information Service*, January 18, 1921, p. 18.

tries were considered the principal obstacles to the increased sale of American goods abroad. This method of regulating the trade balance of various countries was artificial and very difficult of administration. There was a simpler way—to permit the economic law to operate by means of exchange rates. The peg was taken out of exchange. Foreign exchange had always acted before as a regulator within a narrow range, the so-called gold points. Countries other than the United States continued restrictions on the outgo of gold and the game of foreign exchange had to be played according to new rules. It became a very speculative game with great variations. The limit was off. A new element was introduced into ordinary foreign commercial transactions, that of exchange speculation.

As a check to our exports, depreciated foreign exchanges have not acted as sharply as might have been anticipated because of the tendency of our exporters and foreign importers to take risks on exchange coming back. It was logical that the downward swing of foreign exchanges should be held back as long as our government continued to make foreign loans. When it was announced early in 1920 that our government had ceased to make foreign loans, it was natural to predict an early decline in foreign exchanges in relation to the dollar and a great falling off in our exports. Statistics compiled by the Bureau of Foreign and Domestic Commerce show that our balance of exports over imports was \$2,500,000,-000 for the eleven months ending November 30, 1920, as compared to over \$3,500,000,000 for the same period of the previous year. The reason why we have continued to send abroad a large excess of exports has been due, undoubtedly, to a considerable degree, to the tendency to take risks in foreign

exchange coming back. Reliable statistical approximations indicate that there is now an unpaid foreign floating indebtedness to American account of between \$3,000,000,000 and \$4,000,-000,000. This is due in large part to our banks and firms which expect to get their money back in fairly short time.

Our ability to do short-term financing of our foreign trade has been greatly increased by the use of dollar acceptances and the development of an American discount market. There has also been a fair beginning in the sale of long-term foreign obligations in the United States. If our export trade is to hold up we must go even further in "holding the bag."

Forward business has undoubtedly been checked to a marked degree by the difficulty of the foreign exchange situation. Export merchants have been going slow and as safely as possible. They have asked manufacturers to grant them credit so they could grant credit to their customers. A good deal has been heard about "frozen credits." The general situation has tended to concentrate attention on constructive plans for foreign financing.

ECONOMIC QUESTIONS

The ability to extend credit to foreign countries largely depends on their ability to pay. Their raw materials have recently decreased greatly in value. American importers, fearing that the bottom was not reached, have withheld their purchases. The corresponding decline in our imports has been a contributing reason why the exchange situation has become so serious.

At a time when various foreign countries are seriously embarrassed because we are not purchasing their raw materials in normal quantities, an

emergency tariff bill has been brought forward in our Congress to put on a high tariff amounting to an embargo of certain imports. Whatever the significant feature of this bill may be, it has been taken in certain foreign countries to mean that we are attempting to close the door to the entrance of their goods. This has been a disturbing factor in the situation.

There is no way that we can get return payment for our goods to other countries except in the form of imports. If we decide to shut out imports it would be much more difficult to induce American investors to loan money abroad. We can not have the home market all to ourselves and also a big slice of the foreign markets. The future of our foreign trade is bound up to a considerable degree with our attitude on the tariff question.

There is also a certain amount of unrest from a political point of view. Certain sections of the American community feel that it is their privilege to express their opinions on policies of various other countries. However this may be viewed from a moral or political angle, it is not helpful from the standpoint of trade and financing.

A world-wide adjustment is today going on. The fall in prices is universal. This readjustment may be helpful in the long run, but it is creating special difficulties for merchants and manufacturers in various countries at the present time. International confidence will increase as economic readjustment proceeds.

The foreign trade situation is dependent upon the settlement of the international political situation. As long as there is uncertainty business will not go ahead with the confidence it otherwise would. Production in certain countries will not be increased and their buying power restored until they know how they are going to stand.

The German reparation question is one question of this character. It is hard to say how long it will take for the world political situation to be straightened out.

TYPES OF EDGE LAW ORGANIZATIONS

The regulations of the Federal Reserve Board provide that a bank organized under the Edge Law may not have outstanding acceptances and debentures at the same time, except with the approval of the Board. It seems likely that there will be one kind of Edge Law bank, which will devote itself particularly to international commercial banking by the use of bankers acceptances, and another kind of Edge Law bank, which will extend long-term credits through an issue of its debentures.

THE FIRST FEDERAL FOREIGN BANKING ASSOCIATION

The first banking institution that formed under the "Edge Law" was the First Federal Foreign Banking Association, which opened its doors at 40 Wall Street, New York, on June 21, 1920. This institution was formed by a group of manufacturers and bankers, with an initial capital of \$2,100,000 and surplus of \$105,000. Fifteen important banks in Atlantic Seaboard cities were the original stockholding member-banks and others have been added.

It was found by experience that the bankers acceptance was the security which could be readily marketed at discount rates which are practicable. The Federal Reserve Board gave its authority for making acceptances a year in length. The bulk of the business of the bank developed along these lines. The First Federal Foreign Banking Association does not discount bills miscellaneous. In the steady growth of its business, it has estab-

lished relationships with concerns of prime credit stability, negotiating regular lines of acceptance credit with these. A line once established, the exporter sends to the bank his documentary drafts, the bank handles the foreign collection of these through its organization of foreign connections, and the exporter draws a second "clean" draft on the bank, which the bank "accepts" and, if the exporter desires, markets for him. On account of the standing of the group of banks back of the First Federal Foreign Banking Association, and of its Directorate, also on account of its policies of management, this Edge Law bank's acceptances have come into steady demand in the open discount market of the country. The acceptances are eligible for rediscount or purchase at Federal Reserve banks during the last ninety days before maturity.

This Edge Law bank is, therefore, a commercial bank, serving its customers by handling all kinds of international transactions. Its specialty is, of course, the longer credits, but it handles ordinary transactions as well.

THE FEDERAL INTERNATIONAL BANKING COMPANY

The Federal International Banking Company is being formed in the Southern States, with headquarters at New Orleans, but at this writing has not begun business.

It is expected to have a capital of \$10,000,000, of which \$7,000,000 had already been subscribed on January 7. On that date it had over 1,200 stockholders, for the most part small banks in the cotton belt. The enterprise grew out of an organized purpose of financing a large export of cotton, but it has been stated that the company will conduct a general banking business, financing the movement, not only of the South's premier product, but also

that of naval stores, grain, sugar, tobacco, lumber, coal, etc., and of manufactures coming out of the Mississippi Valley through the port of New Orleans.

Several prominent New Orleans banks are represented in the leadership of the movement to found this bank, and they have been backed by committees of leading bankers in nine southern states. The prospectus of the bank does not describe the banking activities which will be undertaken, nor the methods of financing which will be adopted. It is expected, however, that it will do an international commercial banking business somewhat on the same general lines being followed by the First Federal Foreign Banking Association.

FOREIGN TRADE FINANCING CORPORATION

What is described as by far the largest and most comprehensive attempt to take advantage of the possibilities offered by the Edge Law is the Foreign Trade Financing Corporation, the preliminary organization of which is now in the hands of a committee of thirty men appointed by a national conference of bankers, business men and producers, held in Chicago, in December, 1920, for organization. If the plans of these men materialize, the corporation will have a fully paid up capital stock of \$100,000,000, giving it a maximum capacity for the issuance of debentures under the law of \$1,000,000,000, and efforts are being directed to make it as nearly national as possible in its representation of regions of the country and producing and business activities.

The Corporation has been about a year in foundation. It is the result primarily of the effort of a Committee on Commerce and Marine appointed by the American Bankers Association

over two years ago, when that Association pledged itself

to support by every means in its power the development of export trade, to encourage manufacturers to enter upon this field of distribution, and to provide, as rapidly as possible, adequate facilities for financing export operations sufficient to meet every reasonable demand that may arise.

After a long and presumably thorough study of the situation in respect to our machinery for financing our export trade, and after a thorough canvass of the banks of the country, this committee recommended the plan now being carried into effect. Their recommendations were four times approved by the American Bankers Association, and at its annual convention in October of this year the Association empowered its president to call a nation-wide conference of financial and business leaders at the earliest opportunity to consider the plan.

The meeting took place in Chicago, December 10 and 11, and was attended by some 500 bankers, manufacturers, business men and representatives of industrial, commercial and producers' organizations. Before its close it adopted a set of resolutions approving the formation of the corporation, appointed a Committee on Organization of thirty men representing every section of the country to take up its organization and subscribed \$100,000 for preliminary expenses. The Committee on Organization, which has now nearly completed its plans, is headed by John McHugh of New York, Vice-President of the Mechanics and Metals National Bank.

The reasons for establishing the Corporation and its aims and purposes were set forward in a statement by Mr. Charles H. Sabin, President of the Guaranty Trust Company, issued just prior to the Chicago meeting. Mr. Sabin said in part:

Banks, manufacturers, farmers, exporters and individuals generally from every section of the country will be asked to subscribe to the \$100,000,000 capital stock of the corporation, each Federal Reserve District subscribing an amount as nearly as possible proportionate to its resources.

It is the belief of the men who have studied and laid out the plan that such a plan as proposed is essential if the country is to hold the grip on the markets of the world that its full prosperity requires. It has come, in the financing of its export trade, to a blank wall; the only feasible means of surmounting the wall is through agencies which can gain for foreign trade the support of the American people.

Mr. McHugh has announced that an active campaign is to be started to obtain stock subscriptions. He said further that this corporation would not compete with commercial banks in their short-term financing but that it would handle long-term financing which the commercial banks can not do.

CONCLUSION

The need of adequate machinery for extending foreign credits is generally recognized. The Edge Law provides for banking machinery of the greatest safety because of federal incorporation and supervision. If, as may be expected, it is modified from time to time to meet special needs, in accordance with proved experience, it will enable a sound development of more and more extensive foreign financing. The United States today is the great creditor nation. This involves grave responsibilities. It also affords a great opportunity for world-wide expansion of American business and corresponding prosperity for this country.

ANALYSIS OF THE EDGE LAW AND REGULATIONS

1. A Federal foreign banking corporation may engage in foreign or international banking and financial operations.

2. It may engage in local banking and financial operations in foreign countries or in the dependencies or insular possessions of the United States either directly or through the agency, ownership, or control of local institutions abroad.

3. It may establish branches and agencies abroad with the approval of the Federal Reserve Board. It can not have branches in the United States. Agencies in the United States may be established for specific purposes with the approval of the Board, but not for the general business of the corporation.

4. In order to organize its foreign business "directly or indirectly through the ownership of other corporations" it is empowered to invest in American or foreign corporations organized under Section 25 of the Federal Reserve Act, or under the laws of a foreign country, or under the laws of any state, dependency, or insular possession of the United States, provided that any American corporations are not in substantial competition with it, or hold stock in other corporations that are in substantial competition with it, provided also that such corporations are not in the general business of buying or selling commodities or merchandise in the United States. The restriction against holding stock in corporations that are in substantial competition with it does not apply to foreign corporations.

5. It may not invest more than 15 per cent of its capital and surplus in any corporation engaged in banking, nor more than 10 per cent in any other corporation, without approval of the Federal Reserve Board.

6. It can not be a member of any Federal Reserve Bank.

7. It must have a capital of not less than \$2,000,000.

8. A majority of the shares of its stock must be held and owned by citizens of the United States, and every director must be a citizen. The Federal Reserve Board has formulated drastic regulations regarding this, covering affidavits for transfer of stock, etc.

9. No member of the Federal Reserve Board shall be an officer or director, but with approval of the board, directors and

officers of a member bank may serve, and "interlocking" of officers and directors between the "Edge Law" bank and corporations in which it has investments is not prohibited, subject to approval.

10. Its name is subject to approval of the Federal Reserve Board. The Board has ruled that "No corporation which issues its own bonds, debentures or other such obligations will be permitted to have the word 'Bank' as a part of its title. No corporation which has the word 'Federal' in its title will be permitted to have the word 'Bank' as part of its title."

11. It is subject to periodical examination by the Federal Reserve Board and must make reports.

12. One-tenth of the net profits of the institution must annually be carried to its surplus fund until it has a surplus equaling 20 per cent of its capital stock.

AUTHORIZED BUSINESS OF A FEDERAL FOREIGN BANK

1. To buy and sell, discount and negotiate, with or without its indorsement or guaranty, notes, drafts, checks, bills of exchange, acceptances, including bankers' acceptances, cable transfers, and other evidences of indebtedness.

2. To buy and sell, with or without its indorsement or guaranty, securities, including the obligations of the United States or of any state thereof.

3. Approval of the Federal Reserve Board is necessary before it can offer for sale any foreign securities with its indorsement or guaranty.

4. It is prohibited to trade in corporation stocks. (It may buy stocks of certain corporations for investment and later sell them. See Section 4 of above.)

5. It may issue letters of credit.

6. It may buy and sell coin, bullion and exchange.

7. It may lend and borrow money.

8. It may issue its own debentures, bonds and promissory notes under rules prescribed by the Federal Reserve Board, up to ten times its capital and surplus. It must submit each issue to the Federal Reserve Board for approval before making any issue.

9. It may receive deposits in the United

States only as they may be incidental to foreign transactions.

10. It may receive deposits outside the United States. If it has its own bonds, notes or debentures outstanding, the foreign deposits can be taken only when incidental to foreign transactions.

11. It may generally exercise such banking powers as are incidental to the powers specifically granted or as are usual, in the determination of the Federal Reserve Board, in connection with the transaction of foreign banking business.

12. It can not conduct business within the United States except as incidental to international business.

13. It can not engage in buying or selling goods or commodities in the United States, or invest in the stocks of any corporation so engaged.

FEDERAL RESERVE BOARD'S SCRUTINY INTO THE ISSUE OF THE BANK'S OWN OBLIGATIONS

The Board requires, for its approval of an issue of the bank's own obligations:

1. A statement of its condition.
2. A detailed list of the securities used as a collateral for such issues, with maturities, indorsements, guarantees, their collateral, if any.
3. In general terms, the nature of transactions on which the collateral securities were based.
4. Other data in the discretion of the Board.

For its approval of the sale by the bank, with its guarantee or indorsement, of any foreign securities:

1. The character and amount of securities proposed to be sold.
2. Their indorsement, guarantees or collateral, if any.
3. Other data in the discretion of the Board.

PROHIBITION OF ADVERTISEMENT OF BOARD'S SCRUTINY AND APPROVAL

No circular letter or other document advertising the sale of the bank's securities or of foreign securities with its guarantee shall contain any reference to the fact that the Federal Reserve Board has approved the sale.

SOURCE OF THE BANK'S WORKING FUNDS

1. Its capital and surplus.
2. It may borrow from banks or bankers for temporary purposes not exceeding one year without the approval of the Federal Reserve Board.
3. Public or private issues of its "debentures, bonds, notes, or other such obligations" with approval of Federal Reserve Board.
4. Deposits in the United States incidental to foreign business.
5. Deposits outside the United States when permitted by the conditions in the regulations, which are that if it has its own obligations outstanding the foreign deposits must only be incidental to international business.
6. Sale of foreign securities with its indorsement, subject to approval of Federal Reserve Board.

DEPOSITS

1. Can be taken in the United States only when incidental to foreign business.
2. Can be taken without special restrictions abroad when the bank is not issuing its own obligations.
3. Can be taken abroad only as incidental to international business when the bank has its own obligations outstanding.
4. Reserves of 13 per cent must be maintained on deposits in the United States. These reserves may be cash in vault, balance with district Federal Reserve Bank, or balances in a bank which is a member of the Federal Reserve System.
5. Reserves against foreign deposits must be carried in accordance with foreign local law and good practice.

ACCEPTANCES

1. The bank may accept drafts and bills of exchange growing out of transactions of the kind forming the basis of eligible bankers acceptances under Section 13, Federal Reserve Act.
2. It may accept only with approval of the Federal Reserve Board if it has outstanding any of its own notes, debentures, etc.
3. It may accept freely up to six months, and make longer acceptances with the approval of the Federal Reserve Board.

4. Acceptances for account of any individual drawer are limited in aggregate to 10 per cent of the subscribed capital and surplus of the bank, where such acceptances are not fully secured, as described in the Federal regulations. But in case of transactions representing export or import that are fully secured or guaranteed by another bank or banker of undoubted solvency, these do not count toward limitation.

5. After the aggregate of all outstanding acceptances reaches the total of subscribed capital and surplus, all acceptances in excess must be secured 50 per cent. After it reaches twice capital and surplus, all in excess of such amount must be fully secured.

6. Reserves of 15 per cent must be maintained against all acceptance obligations maturing in thirty days or less, and reserves of 3 per cent against all maturing beyond thirty days. These reserves may be in cash, balances with other banks, bankers' acceptances, or securities approved by the Federal Reserve Board.

7. The fact that an individual, firm, company, etc., has reached its borrowing limit of 10 per cent of the bank's capital and surplus does not limit its privileges of having its bills accepted unless the bank itself buys the acceptance, or the individual has failed to cover an accepted draft unpaid at maturity.

8. The liability of a customer on account of an acceptance is not counted as a liability for money borrowed, unless he fails to cover payment at maturity or the bank itself holds the acceptance.

RESERVES

1. The Regulations of the Federal Reserve Board require the carrying of 13 per cent in reserves against any deposits taken in the United States incidentally to foreign transactions.

2. The Regulations require reserves of 3 per cent against all outstanding acceptances of the bank maturing beyond thirty days. Reserves of 15 per cent are required against all outstanding acceptances that will mature within thirty days.

3. The reserve against deposits in the United States may be cash in vault, a balance at the regional Federal Reserve Bank,

or a balance with a bank which is a member of the Reserve System.

4. The reserve against outstanding acceptances must be in liquid assets of cash and/or balances with other banks, bankers' acceptances and/or securities permitted by the Federal Reserve Board.

5. Reserves against foreign deposits must be such as are required by foreign local laws and by sound banking principles.

LIMITATION OF CUSTOMER'S LIABILITIES

1. In the limitation of the total liabilities of any one person, company, firm or corporation, any liabilities of the several members thereof are included as part of the count.

2. The limit for discounts or loans to one concern is 10 per cent of the capital and surplus of the bank, except with the approval of the Federal Reserve Board.

3. The limit of acceptances for any one concern is 10 per cent with the exception noted below in (6).

4. Discounts of bills of exchange drawn in good faith against actually existing values and the discount of commercial or business paper actually owned by the person negotiating the same are not counted as loans in regard to the above limitation of loans.

5. The liability of a customer on account of acceptances is not counted as a loan, unless the Association holds the acceptances or the customer has failed to cover in case an accepted bill is not met at maturity.

6. Acceptance transactions fully secured, or representing export or import of commodities and guarantee by a bank or banker of undoubted solvency, do not count in connection with the 10 per cent acceptance limitation.

LIMIT OF THE BANK'S AGGREGATE LIABILITIES

1. The limit of the Association's aggregate liabilities on account of deposits, indorsements, acceptances, notes, debentures and other such obligations, is ten times its capital and surplus.

2. Indorsements of bills of exchange with not more than six months to run, drawn and

accepted by others than the Association, do not count in determining the amount of liabilities.

3. The Federal Reserve Board may raise the above limit in its discretion.

4. The Edge Law limits the amount of the bank's own obligations (debentures,

bonds and promissory notes) outstanding at any one time to ten times its capital and surplus, without discretion of the Board to increase.

5. The Federal Reserve Board has power to put a limit on the bank's aggregate liabilities in any of the above classes.

A Comparison of English and American Export Trade Methods

By B. OLNEY HOUGH

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IN making any comparison of British and American export trade methods it will be easy to emphasize what may seem to be a certain superiority in the British. Let me say at once, however, that I am a sufficiently enthusiastic American to believe that any such apparent superiority in the trading methods or facilities of the British is more than offset by the versatility, the ingenuity and the aggressiveness of the American. I believe that our qualities will continue to win, as they have been winning for many years past. I believe that the more mature methods which may sometimes be observed in England, as well as certain better facilities which the English possess, will gradually become ours also. That we may the more quickly perfect ourselves calls for a better knowledge of our present deficiencies and perhaps a more intelligent appraisal of existing conditions and methods among our British rivals.

We shall be forced to restrict our survey of methods to characteristics of large and experienced business houses in the two nations. Not all large business concerns either in England or in the United States conduct their foreign business in the wisest or most effective ways; but certain facts stand out as more commonly to be found among

large and experienced English exporters than among similar exporters in our own country. We may consider two classes: first, manufacturers who do their own exporting; second, the professional export merchants who in both countries control an appreciably large proportion of export trade. We can refer only to impressions derived from some of the large and prominent houses in each class, which may or may not be typical, but are sufficiently numerous to make their characteristics notable.

EXPORTING BY MANUFACTURERS

To consider first the methods and policies of large manufacturers in the two countries who do their own exporting, we have to note comparatively few variations. It is difficult to generalize and impossible to determine to which side the scales incline when the practices and methods of individual concerns are reviewed. There is no such thing as an established rule of practice among individual manufacturers in England any more than in the United States. The chief contrasts which are to be noted are psychological, rather than in the actual conduct of business. So far as concerns the practical conduct of export business, it may be noted that British manufacturers no more